

The issue of whether a person incurs a Retailers' Occupation Tax or Service Occupation Tax liability depends upon the nature of the items being produced and the nature of the design work involved. See 86 Ill. Adm. Code 130.2115. (This is a GIL.)

May 4, 2007

Dear Xxxxx:

This letter is in response to your letter dated August 4, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing on behalf of my client, (CLIENT), in hopes to obtain a Private Letter Ruling providing definitive guidance on sales and use taxes resulting from the sale and installation of warehouse racking and equipment. The warehouse racking and equipment may be installed in a new or existing warehouse.

My client is domiciled in CITY/STATE but intends to expand into the state of Illinois. From past experience, we have discovered that certain states treat our commerce as the sale and installation of tangible personal property or as an improvement or fixture to real property in which case my client is often deemed as a construction contractor.

This classification of our commerce typically affects whether we charge sales tax based upon the sales price to our customers or pay use tax based upon our cost and consumption of materials.

The facts and circumstances of a typical sale and installation are as follows:

- CLIENT determines the project specifications based upon telephone calls and / or meetings in Illinois. Typically, the warehouse racking is used to store inventory but, it is possible the racking may hold raw materials used in a production or manufacturing process.

- The Customer provides the warehouse dimensions and product specifications to my client. Based upon this information, CLIENT internally develops a CAD design of the warehouse racking. CLIENT also utilizes a professional engineering firm located in STATE2 to make certain calculations and provide other assistance regarding the final design of the warehouse racks.
- The final blueprints are sent to the customer for their approval.
- My client then delivers a final quotation to the customer separately detailing the sales price of the material, installation, estimated freight, engineering, permit fees, and applicable taxes. The installation price is based upon the entire job and is not a function of time.
- Upon entering into a definitive contract with the customer, CLIENT contracts with a third party manufacturer located in a separate state to manufacture the customized warehouse racks according to the plan specifications.
- Once the product is manufactured, it is shipped in pieces via common carrier FOB Manufacturer directly to the Customer's location in Illinois.
- CLIENT then invoices the customer by specifically detailing the sales price of the material. The freight appears as a separate line item on the invoice and typically represents the actual cost paid by CLIENT to the common carrier.
- CLIENT dispatches its employees to the customer's warehouse in Illinois to install the warehouse racks. The employees may remain onsite for weeks if not months to complete the installation.
- CLIENT periodically invoices the customer based upon the agreed fixed installation price as certain milestones are completed. The charges for installation are separately stated on the invoice and in the master contract. The same invoice may also contain line items separately detailing the sales price of materials, freight, building permit fees paid to cities or counties ('Permit Fees'), sales tax and engineering fees.
- Once the installation is complete, the Customer makes the final payment and signs off on the project.

Description of Warehouse Racking & Installation

Please find Exhibit A enclosed herein which contains pictures of typical warehouse racks made of structural steel and the anchors used to attach the racking to the floor of the warehouse.

Each rack consists of two upright beams and two base plates that are anchored to a concrete floor with $\frac{1}{2}$ " to $\frac{3}{4}$ " concrete wedge ('Concrete Wedge') and epoxy anchors to prevent the steel from being moved or falling over. The anchors are installed to 3 $\frac{3}{4}$ " deep to 5 $\frac{1}{2}$ " deep on average.

Concrete Wedge anchors' design allows them to anchor fixtures into concrete. Once installed, it may only be removed by cutting it from the floor. Concrete Wedge anchors

work by inserting them into a hole drilled into concrete. The Concrete Wedge anchor is then expanded, wedging itself securely in the concrete.

[PICTURE]

Concrete Wedge

(Approximately 6" Long)

The typical rack is 42 inches deep and capable of supporting hundreds if not thousands of pounds of inventory, goods, materials or products. In the aggregate, the racks themselves may weigh hundreds of thousands of pounds as they are made with strong structural steel.

The installation process primarily consists of bolting the various components of each rack together and securing to the floor. Typically, no welding or cutting is required.

Although it is theoretically possible to remove the warehouse racking, significant effort must be made to remove it including but, not limited to, cutting the Concrete Wedge flush with the floor. Upon removal, two holes approximating 1 inch in diameter will appear in the concrete floor where each rack was once anchored. Typically, Concrete Wedges are installed every eight feet. Upon removal of the racking, the building owner generally requires the holes to be re-filled with concrete to repair the damage and mitigate a potential safety hazard. Due to the high cost and customization of the warehouse racking systems installed by my client, these units typically have a long useful life.

The sales price of the projects may surpass \$1,000,000 and the gross profit margins are very low so it is critical that my client fully understands the tax implications when bidding on a project.

Considering the facts and circumstances as described herein, including the pictures appearing in Exhibit A, please address the following matters in the private letter ruling:

1. Should my client charge sales tax to its customer or pay use tax as the consumer of the goods?
2. My client provides itemized invoices so should the tax appear as a line item on the invoice?
3. Based upon the answer to questions (1) and (2), please identify the taxable components of the sale or the items subject to use tax. The itemized components appearing on each invoice are as follows:
 - a. Material
 - b. Installation
 - c. Freight
 - d. Engineering fees
 - e. Permit Fees
4. For items (a) through (e) appearing in question # 3, should we compute the tax based upon our sales price to the customer or compute the tax based upon our purchase price or cost?

5. Are there any exemptions in your state based upon the nature of the customer's business? e.g., the product is exempt from tax as it relates to a manufacturing process, etc.
6. In the event you determine CLIENT is only responsible for Use tax on the cost of materials consumed, is it acceptable to pay such tax to the manufacturer in hopes to minimize the filing burden upon CLIENT?
7. Please provide any other pertinent information with respect to compliance matters involving sales and use taxes that you may find helpful in assisting CLIENT with full compliance.

Please send your response to my office but, addressed to CLIENT.

Thank you for your assistance with this matter. My client and I look forward to expansion into Illinois and fully complying with all rules and regulations.

DEPARTMENT'S RESPONSE

The Department declines to issue a Private Letter Ruling on the issue of whether a racking or conveyor agreement is a sale at retail of tangible personal property or is a sale of service. The Department's auditors are in the best position to make such a determination.

The issue of whether a person incurs a Retailers' Occupation Tax or Service Occupation Tax liability depends upon the nature of the items being produced and the nature of the design work involved. If the item being produced is substantially similar to stock or standard items, even though custom-made, the sale of that item would result in Retailers' Occupation Tax liability. The test for special order items that result in Service Occupation Tax liability is set forth in subsection (b) of the Department's rule "Sellers of Machinery, Tools and Special Order Items" at 86 Ill. Adm. Code 130.2115.

The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so does not incur Retailers' Occupation Tax liability with respect to the sale, if the following tests for exemption are all met in the transaction:

- A) The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- B) the property has use or value only for the specific purpose for which it is produced; and
- C) the property has use or value only to the purchaser. 86 Ill. Adm. Code 130.2115(b).

For example, if a manufacturer of customized shelving is employed to provide engineering or other scientific skill to design and produce the customized shelving on special order for the purchaser in order to meet the particular needs of the purchaser, and the shelving has no value to others than the purchaser for the purpose for which they are produced, then the manufacturer will incur Service Occupation Tax liability on the sale of the shelving, rather than Retailers' Occupation Tax liability.

As to the requirement that the seller be employed primarily for his engineering or other scientific skill to design and produce the property, it is sufficient if the seller is responsible for making a substantial contribution to the designing of the property that is to be produced on special order. See subsection (b)(2) of Section 130.2115. A manufacturer who takes a customer's blueprints and prepares its own drawings that set out the materials, dimensions, and the method of manufacture necessary to create customized shelving and then uses those drawings to manufacture the shelving is generally responsible for making a substantial contribution to the designing of the property that is to be produced on special order as long as the manufacturer is contractually responsible for the engineering of those panels and trusses. This is not affected by the fact that the manufacturer may subcontract out the engineering work to another as long as the manufacturer is contractually responsible for the engineering work.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen use to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Please note that if a manufacturer constructs and sells 50 or more identical sets of shelving in a single repeat order or simultaneous orders from a user (so-called multiple orders), those sales will be deemed to be volume production and will be subject to Retailers' Occupation Tax (rather than Service Occupation Tax) liability based on the total amount received by the manufacturer from such volume production orders. Also, even items that qualify for exemption from the Retailers' Occupation Tax, if sold subsequently without material change to the purchaser for use (so-called repeat orders), will become subject to the Retailers' Occupation Tax because the skill that is involved after the first item is made is production skill and not specialized engineering and design skill. See 86 Ill. Adm. Code 130.2115(a)(4). If a manufacturer also makes retail sales of tangible personal property, such as plywood and other non-manufactured products, that manufacturer will incur Retailers' Occupation Tax liability on those sales.

Please note contractors having contracts with customers to sell and permanently affix tangible personal property to realty incur a Use Tax liability on their cost price of such materials permanently affixed. If the contractors do not remit this tax to Illinois registered suppliers, the contractors must register and self-assess and remit the Use Tax to the Department. See 86 Ill. Adm. Code 130.2075. Sales by construction contractors to customers of completed; permanently affixed materials are sales of real property and are not taxed under the Illinois sales tax laws.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk